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Supreme Court, U.S.
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No. 98-191

In The

Supreme Court of the United States

October Term, 1997

DRAGO DAIC INTERESTS, INC.,

Petitioner,

vs.

NAURU PHOSPHATE ROYALTIES (TEXAS), INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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PARENT COMPANIES, AND NONWHOLLY OWNED SUBSIDIARIES

Respondent Nauru Phosphate Royalties (Texas), Inc.'s parent company is Nauru Phosphate Royalties, Inc., a Delaware corporation. Respondent has no nonwholly owned subsidiaries.

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Respondent Nauru Phosphate Royalties (Texas), Inc. ("Nauru") requests that the Court deny the petition for writ of certiorari seeking review of an opinion of the United States Court of Appeals for the Fifth Circuit. The Fifth Circuit's opinion is reported at 138 F.3d 160, *petition for cert. filed*, 67 U.S.L.W. 3105 (U.S. July 27, 1998) (No. 98-191).

Nauru's citations wili be to the published Fifth Circuit opinion, and to the record below, because the Appendices attached to the petition for writ of certiorari contain errors, and accordingly, Nauru is not confident of their accuracy. For instance, on page 165 of the Fifth Circuit opinion, the court states:

> Not only does it fully incorporate by reference the Development Agreement, the Promissory Note is explicitly referenced throughout the Development Agreement.

By virtue of the margin placement, Appendix A incorrectly indicates that this statement is language in the Promissory Note (Appendix A at 8-9), rather than an observation by the Fifth Circuit. (*Nauru Phosphate Royalties (Texas), Inc. v. Drago Daic Interests, Inc.*, 138 F.3d at 165).

Likewise, Appendix E incorrectly substitutes the word "not" for the correct word "no," in the Award of Arbitrators (Appendix E at 77). The correct language is:

> NPR has no liability for payment of the eight million dollar promissory note. . . .

(R. 37, Ex. A).

STATEMENT OF THE CASE

In January 1990, Nauru entered into a sale and development agreement with three parties, Drago Daic Interests, Inc. ("DDI"), Drago Daic, Trustee ("Daic Trustee"), and Montgomery 666, Limited ("M-666"). Nauru purchased 668 acres of land in Montgomery County, Texas from Daic Trustee and M-666 in order to develop the property into a residential housing subdivision complete with country club, golf course and other amenities.

Nauru paid $5 million in cash to Daic Trustee and M-666 for the 668 acres (Arb. Tr. Vol. 26, Vol. 1 at 00049-00248), and accordingly DDI's claim (Petition at 20) that Daic Trustee and M-666 have not been paid for the land is incorrect. Nauru also executed a contingent, non-recourse $8 million Promissory Note to Daic Trustee and M-666 (the "noteholders"), which would only be payable if the project was successful, as defined by a formula contained in the agreement, *i.e.*, generally, if revenues exceeded expenditures in any given year. (Arb. Tr. Vol. 26, Vol. 1 at 00108-00115, 00142-00220).

Drago Daic, "the man behind" DDI, Daic Trustee and M-666, negotiated the sale and development agreement on behalf of all three parties. (138 F.3d at 166; Arb. Tr. Vol. 1, Response of DDI, Ex. A at 2). Drago Daic insisted that DDI, his wholly owned company, be named the developer of the project, so that DDI could control the project and ensure that the Promissory Note would be paid to the noteholders. (138 F.3d at 165-66).

The sale and development agreement was evidenced by several documents, including an Earnest Money Contract, the conditional $8 million Promissory Note, a Deed of Trust, a Warranty Deed with Vendor's Lien, and a Development Agreement. The Promissory Note fully incorporates the terms

of the Earnest Money Contract and the Development Agreement. (138 F.3d at 165). The signature of the noteholders on the Development Agreement, with a specific reference to two provisions in the Development Agreement, is an affirmation that the noteholders will abide by or comply with the actions required of them by those provisions, and is not a limitation as claimed by DDI. (Petition at 3, 13). As observed by the Fifth Circuit, the noteholders' attempt to enforce other provisions of the Development Agreement binds them to its terms. (138 F.3d at 167).

DDI developed the property for approximately five years. Although certain amenities were constructed, the project was a financial disaster for Nauru. Nauru spent more than $30 million in developing the property, and received only approximately $1 million in return. (R. 14 at 4). DDI's observation (Petition at 4), that Nauru became dissatisfied with costs and expenses, is a gross understatement.

In 1995, as a result of Nauru's dissatisfaction with DDI's management of the project, Nauru terminated DDI as developer, and instituted an arbitration proceeding. DDI's suggestion (Petition at 5) that the noteholders instituted a lawsuit on the Promissory Note in Texas District Court in Montgomery County, Texas, prior to Nauru terminating DDI and filing the arbitration, is a misstatement. Nauru terminated DDI and filed the arbitration prior to the noteholders filing a separate suit in Montgomery County. (Arb. Tr. Vol. 7, Vol. 25, at 33-34, 41). DDI's claim that the noteholders continued to prosecute their state court lawsuit throughout the arbitration (Petition at 6), is likewise a misstatement. The state court judge stayed the noteholders' lawsuit during the pendency of the arbitration. (Arb. Tr. Vol. 5, Vol. 14, at 20-21).

The arbitration hearing lasted approximately four months, and consisted of 55 days of testimony. Thirty-six witnesses

testified and thousands of pages of documents were introduced as exhibits. (Arb. Tr. Vols. 2-15). On February 9, 1996, the arbitrators agreed with Nauru that DDI was responsible for the financial failure of the development, by finding that DDI committed 13 material breaches of the Development Agreement. Nauru then filed an action in federal District Court to confirm the arbitration award, which resulted in the decisions of the District Court and Fifth Circuit below.

ARGUMENT

I.

REASONS FOR DENYING THE WRIT

The Fifth Circuit's decision is correctly decided, based on well established authority, and is not in conflict with the decisions of other Circuits, or with the decisions of the United States Supreme Court.

II.

DDI HAS MADE MISSTATEMENTS OF FACT AND LAW

In the Statement of the Case above, Nauru has pointed out inaccuracies in DDI's petition. But there are more. Pursuant to United States Supreme Court Rule 15.2, Nauru brings to the Court's attention additional misstatements of law and fact contained in the petition.

A. Promissory Note payments were legally dependent on DDI's performance as developer of the project.

DDI claims that the Promissory Note obligations were not legally dependent on DDI's performance as developer, that

certain contractual provisions provide otherwise, and therefore that the Fifth Circuit's decision is in manifest disregard of the law. (Petition at i, 4, 9, 15, 20). These claims are incorrect.

The Fifth Circuit properly determined that the Development Agreement had to be performed by DDI without material breach in order for the noteholders to be paid. (138 F.3d at 165). Accordingly, the Promissory Note is an interest contingent upon faithful performance of the contract by DDI. (138 F.3d at 167). These determinations by the Fifth Circuit are supported by provisions in the Promissory Note and the Deed of Trust. These provisions, Section 4.2 in the Promissory Note and Section 7 in the Deed of Trust, provide that if DDI is in default under the Development Agreement, then the noteholders cannot accelerate the Promissory Note or pursue any remedies under the Deed of Trust. (Arb. Tr. Vol. 26, Vol. 1 at 00108-00141). Because the Promissory Note is a non-recourse note, the noteholders can only enforce the Promissory Note by foreclosing on the property under the rights provided in the Deed of Trust. The noteholders therefore cannot recover under the Promissory Note if DDI is in default under the Development Agreement.

These contract terms are consistent with the background of the sale and development agreement. Payment of the Promissory Note was never an absolute obligation, but was dependent upon a successful development of the project. In effect, the parties to the sale and development agreement agreed, at the outset, that if the project was unsuccessful, then the Promissory Note would not be paid. Because DDI, the entity that Drago Daic insisted be placed in charge of the project to ensure that the Promissory Note would be paid, was responsible for the financial failure of the development, it follows that Nauru's liability on the Promissory Note would terminate.

In an attempt to contest these clear provisions in the Promissory Note and Deed of Trust, DDI cites a provision in

the Development Agreement. The arbitrators had all of these contractual provisions before them, including the provision DDI now relies upon, and concluded that Nauru has no liability under the Promissory Note. It is well settled that a court "may not reconsider an award based on alleged errors of fact or law or misinterpretation of the contract." *Exxon Corp. v. Baton Rouge Oil & Chemical Workers Union*, 77 F.3d 850, 853 (5th Cir. 1996) (citing *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 36 (1987)); *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1320 (5th Cir. 1994) ("We must sustain an arbitration award even if we disagree with the arbitrator's interpretation of the underlying contract as along [sic] as the arbitrator's decision 'draws its essence' from the contract."). All doubts are resolved in favor of the validity of the arbitration award. *Dole Ocean Liner Express v. Georgia Vegetable Co.*, 84 F.3d 772, 775 (5th Cir.), *opinion modified on other grounds*, 93 F.3d 166 (5th Cir. 1996). Therefore, DDI's arguments regarding the interpretation of an isolated contract provision is not an issue this Court can or should reach.

B. The Promissory Note issue was before the arbitration panel, and the noteholders were on notice thereof.

DDI also misstates the facts and law when it claims that the Promissory Note issue was not before the arbitration panel, and that the noteholders had no notice that the promissory note issue could be decided by the arbitrators. (Petition at i, 11-12, 17-18).

The issue of liability on the Promissory Note was raised in the arbitration by both pleadings and evidence. The Fifth Circuit correctly found that Nauru's demand for arbitration made liability on the Promissory Note an issue before the arbitration panel. (138 F.3d at 165). In DDI's responsive pleading, DDI claimed that Nauru was liable under the Promissory Note, based

on the claim that Nauru breached the Development Agreement. (Arb. Tr. Vol. 1, Response of DDI, Ex. A at 9). Witnesses for both parties testified in the arbitration about liability under the Promissory Note. A witness for Nauru testified that no money was due under the Promissory Note (Arb. Tr. Vol. 5, Vol. 16 at 184-185), and a witness for DDI testified that the Promissory Note could have been paid but for Nauru's acts (Arb. Tr. Vol. 13, Vol. 48 at 274-275). Because the issue of liability under the Promissory Note was raised by the pleadings of both parties, and because the issue of liability under the Promissory Note was disputed in testimony before the arbitrators, the arbitrators had authority to decide the issue.

The Fifth Circuit also correctly noted that the noteholders had notice that liability on the Promissory Note would be resolved by the arbitration panel. (138 F.3d at 166). The District Court found that Drago Daic,"the man behind" DDI and the noteholders, fully participated in the arbitration. (138 F.3d at 166). Their notice is further evidenced by a February 9, 1995 letter, which was signed by all three parties, DDI, Daic Trustee and M-666, and which was filed and made a part of DDI's pleadings in the arbitration. (Arb. Tr. Vol. 1, Response of DDI, Ex. A). In this letter, all three parties, DDI and the noteholders, asserted that Nauru was liable to the noteholders under the Promissory Note for its alleged breaches of the Development Agreement. DDI then attempted to prove in the arbitration that Nauru materially breached the Development Agreement. It is not difficult to understand why the arbitrators found no liability under the Promissory Note, when they determined that Nauru did not materially breach the Development Agreement.

C. DDI and the noteholders have related and congruent interests, and the decision binding the noteholders is based on recognized authority.

DDI claims that the Fifth Circuit cited no recognized basis for binding the noteholders, that DDI and the noteholders do not have related or congruent interests, that their rights are not legally derivative, and that the relationship between DDI and the noteholders does not constitute privity. (Petition at 12, 14-15). These claims are misstatements of fact and law.

The Fifth Circuit has cited a number of recognized bases for binding the noteholders, including the determination that the noteholders are third party beneficiaries (138 F.3d at 166), the fact that the broad arbitration clause was intended to reach all aspects of the relationship between the parties, including liability on the Promissory Note (138 F.3d at 165), the noteholders' attempts to enforce the agreement containing the arbitration clause (138 F.3d at 167), and the fact that the noteholders and DDI had related and congruent interests which were properly advanced and adequately represented during the arbitration (138 F.3d at 166-67).

The Fifth Circuit and the District Court found that the interests of DDI and the noteholders were related, congruent, similar, and the same. (138 F.3d at 166-67). The Fifth Circuit further determined that the interests of the noteholders were adequately represented by DDI, and that the record established that there was such an identity of interest that it was fair and appropriate to bind the noteholders. (138 F.3d at 166-67).

The evidence of related and congruent interests is overwhelming. In correspondence to the President of the Republic of Nauru, DDI asserted that the issue of the $8 million

Promissory Note must be resolved. (Arb. Tr. Vol. 30, Vol. 18 at 006656-006657). In the February 9, 1995 letter attached to DDI's pleadings in the arbitration, DDI, Daic Trustee and M-666 stated that one of the primary interests of DDI was to ensure that the Promissory Note would be paid. (Arb. Tr. Vol. 1, Response of DDI, Ex. A at 5). They further claimed in this letter that Nauru's actions were breaches of both the Development Agreement and the Promissory Note, and that those actions had resulted in damage to the noteholders. (138 F.3d at 167; Arb. Tr. Vol. 1, Response of DDI, Ex. A at 9). Accordingly, these three parties had a common interest in proving common questions of law and fact, *i.e.*, that Nauru breached the Development Agreement. Furthermore, the fact that the noteholders have attempted to make res judicata and collateral estoppel claims against Nauru based upon certain findings made in the arbitration (Appellant's Brief before the 5th Circuit at 27), is clear evidence that the noteholders claim to have derivative rights from DDI. The assertion of derivative rights, and an interest in proving common question of law and fact, establish that DDI and the noteholders are in privity. That both the Promissory Note and Deed of Trust provide that the noteholders cannot enforce their lien while DDI is in default under the Development Agreement, is also evidence of derivative rights and related and congruent interests. If DDI and the noteholders did not have related and congruent interests, then DDI would not be filing this petition and objecting in this Court to the Fifth Circuit's determination that the noteholders are bound by the arbitration findings.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

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